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TEST #15
1 HOUR CREDIT
LEGAL ETHICS

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**Of Counsel: Avoiding Conflicts**
California Joan once again lectures Meryl Terpitude, this time on the perils of disqualification

By ELLEN R. PECK

**EDITOR'S NOTE:** *This is the second of two MCLE self-study packages, each of which will earn one hour of MCLE credit in legal ethics. Part 1 appeared in the December 1999 issue of the California Bar Journal. Both parts also may be found online at the State Bar web site, www.calbar.org.*

"What a nightmare I had last night!" California Joan exclaimed to her partner, Meryl Terpitude, on the morning of Jan. 3, 2000, as she entered the firm's coffee room for a cup of double cappuccino. "Happy new millennium to you too! What was the nightmare?" invited Meryl.

"I was in the firm's board room, sitting behind stacks of files, facing my partners. But instead of lawyers, my partners were doctors, chiropractors, ambulance company owners and other business people. They were reviewing my files; asking me about the profitability of certain cases; exhorting me to take less discovery on most of my cases; and asking me why I needed to bring motions for summary judgment on some. I woke up screaming when they told me to dump about 25 percent of my cases because they weren't going to make enough money," shuddered Cali.

"I had almost the same dream, but I thought I was in heaven!" exclaimed Meryl. "There I was, in the biggest board room ever. My partners were lawyers, accountants, captains of industry and entrepreneurs. We were sharing strategies on cases and business ventures and it was exciting. I woke up as we were going over the firm's profits. The profits were bigger in a multidisciplinary practice than they ever had been with the Law Firm!

"Reflecting on the new millennium, I realized that if the American Bar Association proposal on multidisciplinary practice is adopted, my dream will become a reality in my professional lifetime. That's something to look forward to!" Meryl ruminated aloud.

"Well, Meryl, for the sake of the profession, I hope the 21st century sees your dream, not my nightmare, come true," Cali retorted. "Until multidisciplinary practice becomes a reality, lawyers still have the same duties, obligations, liabilities and risks that we had in the last century."

"Speaking of risks, Cali . . . could we talk about some conflict of interest issues that came up in a few of my cases?" Meryl asked. After Cali sat down in his office, nodding her assent, Meryl cleared his throat and began with his first ethical dilemma of the new century:

"Elephantine Enterprise is suing the Firm's client, Gargantuan Group, in a piece of complex commercial litigation. Gargantuan asked me to build a 'dream' defense team, so I consulted top rate trial attorney, Otto Counsel, about joining the team. We spent hours on the phone and in meetings together. I told Otto Gargantuan's theories regarding defenses to the claims, my outline of discovery strategy, and the procedural posture of the case. We discussed different litigation strategies, the results of some preliminary research he did, and his analyses of the issues. We were finalizing his retention, when, just before the New Year, the law firm of Draft, File & Serve subbed in as trial counsel for the plaintiff, Elephantine Enterprise. I was devastated." Meryl almost whined.

"So, where's the beef, Meryl?" Cali asked with puzzlement.

"Well," Meryl went on, "Otto Counsel is 'of counsel' to Draft, File & Serve . . . he's even listed as 'of counsel' on their stationery. So, of course, Gargantuan told me to advise Otto we would not be using his services. Gargantuan is mad at me for consulting Otto; they suspect that Otto has probably told Draft, File & Serve everything. I don't know what to do."

Cali's ethical expertise snapped into action. "Meryl, you should immediately bring a motion to disqualify Draft, File & Serve. Your case is virtually identical to a recent California Supreme Court case — People ex rel. Department of Corporations v. Speedee Oil Change Systems Inc. ("Speedee Oil") (1999) 20 Cal.4th 1135, 86 Cal.Rptr.2d 816, 980 P.2d 371 — disqualifying a law firm because of the confidential information received about an adverse party in the same lawsuit by a lawyer who was 'of counsel.'"

"But, we did not retain Otto." Meryl said skeptically.

"It doesn't matter, Meryl. The Supreme Court observed that the duty of confidentiality 'extends to preliminary consultations by a prospective client with a view to retention of that lawyer, although employment does not result.'" (Speedee Oil, supra, 20 Cal.4th at pp. 1147-1148.) "Moreover, for the purposes of conflicts of interest analysis, an attorney represents the client when the attorney knowingly obtains material confidential information from the client and renders legal advice or services as a result. (Speedee Oil, supra, 20 Cal.4th at p. 1148.) Just like that case, Otto obtained material confidential information about Gargantuan's case and is deemed, for conflict purposes, to have represented Gargantuan."

"Well, that confidential information can't be imputed to Draft, File & Settle, since Otto is not a partner or associate in the firm, can it?" queried Meryl.

"Yes, confidential information acquired by a lawyer who is 'of counsel' to a firm can be imputed to the firm for vicarious disqualification purposes." Cali recited the Supreme Court's reasoning:

"First, the law firm which lists an attorney as 'of counsel' on its letterhead or other listing is making an affirmative representation to its clients that the services of that attorney are available to the clients of the firm. (Speedee Oil, supra, 20 Cal.4th at p. 1153.)

"Second, the Supreme Court adopted the definition of 'of counsel' as set forth in rule 1-400(E), standard 8. The relationship between a lawyer serving as 'of counsel' (who is one other than partner or associate, or law corporation shareholder or officer) and a firm is close, personal, continuous and regular. (Speedee Oil, supra, 20 Cal.4th at p. 1153.)

"Third, the close, personal, continuous and regular relationship between a law firm and an attorney affiliated with it as 'of counsel' contains many of the same elements that justify vicarious disqualification applied to partners, associates and members. (Speedee Oil, supra, 20 Cal.4th at p. 1154.)

"Finally, where a lawyer is held out to the public as 'of counsel' to a law firm, the law firm and the 'of counsel' relationship must be considered a single de facto firm for the purposes of rule 3-310, Rules of Professional Conduct. Where one is disqualified, the disqualification is imputed to the other. (Speedee Oil, supra, 20 Cal.4th at p. 1154, 1156.)

"Rule 3-310(E), California Rules of Conduct, prohibits attorneys from accepting, without the client's informed consent, employment adverse to the client, where by reason of the representation of the client, the attorney has obtained confidential information material to the employment. Since Otto obtained confidential material information about Gargantuan's case, that confidential information is imputed to Draft, File & Serve because it is holding out Otto as its 'of counsel' to the public. Draft, File & Serve was therefore precluded from accepting any employment in the same case which is adverse to Gargantuan," Cali concluded.

"But what if Otto asserts that he never talked to anyone at Draft, File & Serve?" asked Meryl.

"That's insufficient to prevent disqualification. The Supreme Court found that the mere assertion that the 'of counsel' attorney had not and would not in the future discuss the case with other members of the firm was insufficient to establish any formal screening procedure. Although California courts have not yet accepted screening, the Supreme Court held out a ray of hope that screening might rebut the presumption of shared confidences and avoid disqualification. (Speedee Oil, supra, 20 Cal.4th at p. 1151-1152) But, even if a court would accept screening as a defense to disqualification, Otto and Draft, File & Serve would have to show that they instituted formal screening procedures as soon as they learned of the conflict, which I doubt," replied Cali.

"I'm just so relieved that Gargantuan has a remedy!" sighed Meryl. "How ironic that I am on the other end of the conflict sword, for a change."

"Wait a minute . . . I am also 'of counsel' to another firm. Does this mean that I could be vicariously disqualified from representation of my clients because of my affiliation with that law firm?" Meryl asked with alarm.

"Yes, it's a possibility," Cali said. "I recommend that any 'of counsel' and firms with which they are associated should share a conflict data base. Neither the 'of counsel' nor the affiliated firm or lawyer should accept any adverse employment without checking the mutual data base, on pain of disqualification. By the way, the Firm has already instituted shared conflicts data bases with all of our 'of counsel.'"

"Let me ask you about another issue involving confidential information" Meryl went on quickly. "From 1980-1990, I defended Colossal Construction Company in most of the construction defect litigation against it. From 1990 to the present, although I have not represented Colossal, I have served as monitoring counsel to Colossal's underwriter, Warranty Bond Co. In that capacity, I have monitored all construction defect litigation in which Colossal was a defendant, advising Warranty about settlement, suggesting certain defenses and other litigation strategy.

"Bay Area County has asked just me to file a construction defect action against Colossal for its failure to supervise subcontractors in a dam construction project. I don't think it is substantially related to any litigation that I handled for Colossal in the past. Are there any problems with me taking the case?" asked Meryl hopefully.

"I do not think you can," Cali began. "Your proposed representation is very similar to a recent disqualification case, Morrison Knudsen Corp. v. Hancock, Rothert & Bunshoft, LLP (1999) 69 Cal.App.4th 223, 81 Cal.Rptr.2d 425. In that case, the Court of Appeal held that monitoring counsel for an underwriter owes a duty to maintain the underwriter's client's confidential information and not accept representation adverse to that third party, which is substantially related to the confidential information acquired in its role as monitoring counsel."

"The substantial relationship test in H.F. Ahmanson & Co. v. Salomon Brothers Inc. (1991) 229 Cal.App.3d 1445, 1455, 280 Cal.Rptr. 614 required three elements: similarity between the two factual situations, similarity between the legal questions posed, and the nature and extent of the attorney's involvement with the cases. I think I can beat that test and avoid disqualification. My case against Colossal involves the negligent use of a special kind of soils in a dam project. I never had any case, either as monitoring counsel or as Colossal's counsel, involving this particular kind of soils. So the factual and legal issues are not similar," Meryl pointed out triumphantly.

"Please reconsider, Meryl. Morrison Knudsen Corp. v. Hancock, Rothert & Bunshoft, LLP, supra, 69 Cal.App.4th at p. 234 observed that since the facts of cases are never entirely alike, no cases would ever be substantially related if they could be distinguished on such narrow grounds," countered Cali. "Here's what a Court may find:

"Like the Morrison case:

You've monitored Colossal cases involving charges of negligent engineering services and construction management claims. (Morrison, supra, at pp. 234-235.)

You're monitoring other cases involving negligent supervision in connection with soils issues and this case involves failure to properly supervise the choice of the use of the correct soils for the project. (Mor-rison, supra, at p. 235.)

You have considerable exposure (for 20 years) to Colossal's litigation policies and strategies. (Morrison, supra, at p. 235.)

"Not only are the factual issues similar, but the legal issues in prior cases are similar to the present case, since both involve duty of care issues rendering professional services on construction projects. (Morrison, supra, at p. 235.) And you admit that you have been extensively involved in representing Colossal and in monitoring its litigation defense.

"I believe it's probable that you will be disqualified if you accept this representation and that you might even face breach of fiduciary duty claims against the Firm," Cali said flatly.

For a moment, Meryl was dejected. Then a new idea brightened his face. "Well, then, I won't sue Colossal. Bay Area County has claims against Colossal's independent subsidiary, Subsidiary Engineering Co. Since the greatest claims are against Subsidiary, we don't even have to name Colossal. Best of all, I've never represented Subsidiary."

"Well, Meryl, last month we discussed that Brooklyn Navy Yard Cogeneration Partners v. Superior Court (1997) 60 Cal.App.4th 248, 70 Cal.Rptr.2d 419 held that the representation of a subsidiary did not necessarily create ethical duties to its parent corporation, precluding representation of adverse interests against the parent assuming that one was not the alter ego of the other. Recently, Morrison Knudsen Corp. v. Hancock, Rothert & Bunshoft, LLP, supra, 69 Cal.App.4th at pp. 238-248, criticized the alter ego test, and observed that if a parent and Subsidiary have a unity of interests, then they will be considered one entity for the purpose of maintaining confidential information. Unity of interests can be grounded upon shared legal departments, the subsidiary's lack of independent contractual authority, integrated operations and management personnel, overlapping functions and personnel on the same project, or financial information about Colossal which might affect the settlement posture of Subsidiary. If a court finds a unity of interests between Colossal and Subsidiary, it will likely disqualify you and the Firm," Cali counseled.

Meryl thought for a moment and said that he would either seek Colossal's informed consent to represent Bay Area County or would not take the case.

"I probably should not even mention the next case to you, because it involves suing the former client of an underwriting client similar to Morrison," Meryl said. "About three years ago, I represented Investment Banking Firm (IBF), which served as an underwriter for DOTCOM's public stock offering, purchasing 1 million shares of DOTCOM's stock for resale to the public. On behalf of IBF, I prepared the registration statement, prospectus and certain regulatory filings, conducted a due diligence investigation concerning the correctness of DOTCOM's representations, and worked to qualify the stock under the 'blue sky' laws of states where the securities were to be sold. I frequently met DOTCOM's personnel and obtained information from them. DOTCOM was separately represented by counsel and also agreed to pay my fees for representing IBF. IBF now wants me to represent it, in filing an action against DOTCOM for breaching the underwriting agreement, by selling shares of its stock on its own, and breaching the warrant agreement by failing to register the shares."

"Believe it or not, a new case Strasbourger Pearson Tulcin Wolff Inc. et al., v. Wiz Technology Inc. (1999) 69 Cal.App.4th 1399, 82 Cal.Rptr.2d 326, rev. den. 5-19-99, under similar facts, suggests that you have acquired no confidential information and therefore would not be disqualified." Cali advised.

"I don't get it," Meryl said in exasperation. "Morrison and Strasbourger both involve taking an adverse interest to an underwriter's customer, where the underwriter is the firm's client. How can the opposite results be harmonized?"

"The key to when a third party's information acquired from a client must be kept confidential by a lawyer, is the third party's reasonable expectation of confidentiality. Just like the company in Strasbourg-er, IBF had no duty of confidentiality to DOTCOM and DOTCOM had no reasonable expectation that IBF would maintain confidentiality of information being gathered for public dissemination. By contrast, the company in Morrison, supra, had a reasonable expectation that its underwriters would maintain its litigation strategy and private financial information confidential during the course of litigation," replied Cali.

"OK, here's my final concern: Before I started consulting with you, I defended two clients, Cain and Able, who had potential conflicts of interest, in commercial litigation. I sent them both a potential conflicts disclosure, but Able never got around to signing his consent to the joint representation. I got a terrific result, staving off all fraud and other potential punitive damages, with a very nominal judgment against them. Able has not paid the Firm and argues that I should not get any fees because I did not comply with rule 3-310(A) in getting his consent to the potential conflict. Is there any hope?" Meryl asked fearing the worst.

"Did the potential conflicts ever become actual conflicts?" asked Cali.

"No. No potential conflict ever ripened to an actual conflict and no other actual conflict arose. It was a smooth case," replied Meryl, his overdue fee hanging in the balance.

"Well, there was a 'good news' case for lawyers that may assist you: Pringle v. La Chapelle (1999) 73 Cal.App.4th 1000, 87 Cal.Rptr.2d 90. The Court held that the violation of a rule of professional conduct does not automatically preclude an attorney from obtaining fees. It also held that a client, seeking to prevent an attorney's recovery for past due fees, must prove that the attorney engaged in a 'serious' violation of the attorney's responsibilities. The Court upheld the attorney's right to fees because the client had not proven that the rule violation was incompatible with the faithful discharge of the lawyer's duties," Cali responded. (Pringle, supra, 73 Cal.App.4th at p. 1005-1007.)

"The Court did not distinguish between a 'serious' violation, which would preclude fees, or a 'non-serious' violation, which does not (Pringle, supra, 73 Cal.App.4th at p. 1006)," Cali went on. " However, the Court based its holding upon cases precluding fees for actual conflicts of interest. (Pringle, supra, 73 Cal.App.4th at p. 1006, fn. 4.) Therefore, a good rule of thumb is that there must either be one or more actual conflicts or potential conflicts coupled with demonstrated harm and the absence of informed written client consent in order for a client to preclude an attorney's recovery of fees."

"Well, Cali, it sounds like I might be able to get those fees paid after all. The new millennium is looking better already!" Meryl exclaimed brightening.

"Meryl, as we enter the 21st century, the Courts are continuing to expand the application of the duty of loyalty, expanding our duties of confidentiality from clients to third parties and expanding imputed knowledge and vicarious disqualification to other law firm affiliates," Cali summarized. "Stay tuned to 'the biggest ethics show on earth' to see whether these trends will continue in the future."

*Ellen R. Peck is a former trial judge of the State Bar Court, State Bar of California (1989-1995), a former ethics counsel to the State Bar of California and the American Bar Association, the vice chair of the State Bar Committee on Professional Responsibility and Conduct and the immediate past chair of the Los Angeles County Bar Association's Professional Responsibility and Ethics Committee. She is a co-author of Vapnek, Tuft, Peck & Weiner (1997) "The Rutter Group California Practice Guide — Professional Responsibility."*

# Test — Legal Ethics
# 1 Hour MCLE Credit

This test will earn 1 hour of MCLE credit in Ethics.

1. True/False. If the American Bar Association proposal on multidisciplinary practice is adopted, lawyers will be able to have nonlawyers as their partners, even if some activities of the partnership constitute the practice of law.

2. True/False. If the American Bar Association proposal on multidisciplinary practice is adopted, lawyers will be able to share the profits of law firms with nonlawyers.

3. True/False. In order to be successful in disqualifying an attorney that possesses material confidential information adverse to a party, the party must prove that he or she had a fee agreement with the lawyer.

4. True/False. The duty of confidentiality does not extend to preliminary consultations by a prospective client with a view to retention of that lawyer, when employment does not result.

5. True/False. For the purposes of conflicts of interest analysis, an attorney is deemed to represent the client when the attorney knowingly obtains material confidential information from the client and renders legal advice or services as a result.

6. True/False. Confidential information acquired by an "of counsel" cannot be imputed to the firm with which the "of counsel" is affiliated.

7. True/False. The law firm which lists an attorney as 'of counsel" on its letterhead or other listing is making an affirmative representation to its clients that the services of that attorney are available to the clients of the firm.

8. True/False. An "of counsel" relationship with a law firm is not that of partner or associate, or law corporation shareholder or officer.

9. True/False. An "of counsel" relationship with a law firm is close, personal, continuous and regular.

10. True/False. The close, personal, continuous and regular relationship between a law firm and an attorney affiliated with it as "of counsel" contains many of the same elements that justify vicarious disqualification applied to partners, associates and members.

11. True/False. There are no circumstances wherein a law firm and its affiliated "of counsel" must be considered a single de facto firm.

12. True/False. Rule 3-310(E), California Rules of Conduct, prohibits attorneys from accepting, without the client's informed consent, employment adverse to the client, where, by reason of the representation of the client, the attorney has obtained confidential information material to the employment.

13. True/False. Lawyers' representations that they had not, and would not in the future, discuss a conflict case with other members of the firm were enough to establish a formal screening procedure.

14. True/False. In order to be a defense to disqualification in California, a law firm with a conflict based upon the possession of confidential information could show that it instituted formal screening procedures at any time after learning of the conflict.

15. True/False. The substantial relationship test requires proof of three elements: (1) similarity between the two factual situations, (2) similarity between the legal questions posed, and (3) the nature and extent of the attorney's involvement with the cases.

16. True/False. The representation of a subsidiary did not necessarily create ethical duties to its parent corporation, precluding representation of adverse interests against the parent assuming that one was not the alter ego of the other.

17. True/False. A lawyer owes no duty to maintain a third party's information confidential even though acquired during the representation of an underwriter, absent the third party's reasonable expectation that the underwriter has a duty of confidentiality.

18. True/False. The violation of a rule of professional conduct automatically precludes an attorney from obtaining fees incurred in the representation.

19. True/False. If an attorney engaged in a "serious" violation of the attorney's responsibilities in a matter, the attorney may not be eligible to recover for the work done on that matter.

20. True/False. Unity of interests between a parent and subsidiary corporation can be grounded upon shared legal departments, the subsidiary's lack of independent contractual authority, integrated operations and management personnel, and overlapping functions and personnel on the same project.

**Certification**

- This activity has been approved for Minimum Continuing Legal Education credit by the State Bar of California in the amount of 1 hour, of which 1 hour will apply to Ethics.

- The State Bar of California certifies that this activity conforms to the standards for approved education activities prescribed by the rules and regulations of the State Bar of California governing minimum continuing legal education.

**MCLE ON THE WEB**
**TEST #15 – Of Counsel: Avoiding Conflicts**
**1 HOUR CREDIT**
**LEGAL ETHICS**

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